

Dr. Imre Zoltán Nagy:

The Fight against income evasion in Hungary

1. Summary

The evasion of income causes the national budget of Hungary great damage. Just the partial prevention of it would benefit greatly to the state balance and the realization of the economic policy in Hungary. Repelling income evasion can only be achieved by various means. These are the following: To identify and abolish its reasons and causes; to post strict regularizations consistent with the EU legislation; to close legal gaps; not to concentrate on penalties; to reduce high taxes and the exorbitant income centralization of the state; to take the moral education for serious as well as the legal harmonization and effect analysis for the various decisions.

2. The size of the unseen income

According to an estimation of experts the ratio of income evasion in the developed industrial countries ranges from 5 up to 20 % in relation to the annual gross domestic product (GDP). (Numerous experts assume that the percentage of the unseen income in the developed countries is in the range of 20 and 50 %.). In Hungary the GDP in the year 2007 was 25.374 HUF (the GDP was 0, 6 % higher in the year 2008). Having the national centralization of income in Hungary of over 50 %, (in the year 2006 the centralization of income in Hungary was 54,6%, which is extremely high and damaging according to business experts of the Middle-European region), an annual national minimal income deficit of 2.500 bn. HUF (10 bn. Euro) is to expect. The centralization of taxes in Hungary is approx. 38%, the entire national tax deficit is around a minimum of 1.900 bn. HUF (7 bn. Euro) per year. These matters of fact are very problematic for Hungary and the situation is made even more difficult by the fact that 60% of the tax and contribution income comes from Budapest and the area of Pest (environs of Budapest). The reasons for the high level of the unseen income in Hungary are traced back to numerous factors, whereas among others the fact is essential that the modern tax system in Hungary was introduced as recently as the year 1988 by the time of the change of the regime.

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
%	39,1	39,2	38,6	38,34	37,9	37,7	37,5	37,2	38,2	39	39,8

Chart 1. Tax centralization in Hungary, the tax and contribution revenues of the Hungarian national budget in % of the gross domestic product.

Sources: 1. Békesi, lecture, Mindentudás

Egyeteme, 2006, <http://www.mindentudas.hu/bekesilaszo/20060917bekesi1.html?pldx=3>, 2. Világgazdaság 2007

06.13, <http://vg.hu/index.php?apps=cikk&cikk=176927&fr=hk>, 3. MTI 2009 06.26. <http://www.origo.hu/uzletinegyed/valsag/20090626-oszko-33-szazalekracsokkenhet-az-adocentralizacio.html>

The Hungarian centralization of taxes is insignificantly lower than the average tax centralization of the EU countries (39-40%). Comparing Hungary's rate to those of the Baltic countries and of Ireland, the Hungarian centralization of taxes turns out to be significantly higher. Beyond that it even rises above the level of the "Visegrad" - countries (Poland, Slovakia, Czech Republic and Hungary) (30 – 36 %)

3. The reasons for income evasion

In general it is right that worldwide the moral concerns regarding evasion of income are decreasing. This fact is certainly connected with the rising egoism and strongly going down collective spirit. During the analysis of the reasons first of all the rational, economic, so called traditional models, have to be mentioned. These explain the evasion of income as a risk burdened decision making problem, where the tax subject wants to increase its income by evasion, whilst probably the following aspects are taken into consideration:

- I. The probability of detection,
- II. The dimension of financial and other penalties
- III. The general tax burden, the height and slope of the differential tariff and the extent of the untaxed income
- IV. The extents of the actual income

The probability and elevated risk of detection diminish the dimension of income evasion. The successful governmental financial audits signify very good prevention. However international researchers could not statistically prove that the extent of penalties (additions and fines) has an essential impact on income evasion. The explanation is obvious. As a matter of course the determination of penalties is among the competences of the legislation, while the auditing and hearing of the taxpayers is business of the tax offices. Parliament and judiciary are not capable to adjust the penalties for income evasion accordingly fast. According to this no positive results are achieved and the unsolicited processes are not repressed. Naturally in the

parliament the political aspects of the decisions are of importance as well. On the other hand in the case of income evasion a penalty does not very much act as a deterrent.

The research for the causes of income evasion takes more and more psychological, sociological and other aspects into consideration. This is right as it is undisputed that the particular factors determining income evasion show to advantage through the psychological and sociologic regularities of the taxpayers' behaviour.

Worldwide it is the widespread vision that one of the main motives of income evasion is the high average tax burden. Furthermore addition high charges lead to an even stronger illegal handling of income (health and annuity insurance contributions, employer and employee social security contribution). It is already outlined that the Hungarian tax burden is very high, especially in comparison to the neighbouring countries and Eastern European competitors. The international experiences prove that the taxpayers react on an increase of the average tax burden by 1 % with an increase of income evasion by 8 %. This stochastic correlation that depends on country-specific factors shows even so that the extent of income evasion as a reaction on tax increase is much higher than the extent of the actual tax increase. Many tax experts consider this thesis to be conversely true well. That means: With a tax reduction the income evasion would decrease too and in this case the state could collect higher revenue. However this is not to prove, especially not with a short term view. In my opinion here are complicated coherences, which motivate the taxpayers to evade income.

4. Specific reasons for income evasion in Hungary

Besides the presented international factors also other various factors contributed to the increasing income evasion in Hungary. While these reasons apply for other countries as well are they rather specific and ordinary for Hungary. The opening of the "second economy" made the transition to market economy in Hungary much easier (From the beginning to the end of the 1990s Hungary was together with Slovenia the leading power in the expansion of market economy in Middle and Eastern Europe). Through the "second economy" (economic syndicates in industry and trade as well as individual domestic economies in the case of agricultural cooperatives and state domains) in Hungary experiences on market economy could be treasured. Additionally certain adaptability developed as a reaction on the economy of scarcity at that time. The second economy which was the only possibility to make an autonomic decision contributed substantially to the reform process. Certainly this was not the best initial point for the development of market economy, because the participants of the second economy could not plan for the long term due to frequent rule changes. In lieu they

tried to maximize the profit in the short term. This inevitably philosophy of short term profit maximizing was confronted with the philosophy of sustainable economic management.

Another problem was the increasing number of cases of bribe payments and corruption, which became practice because of uncertainties and supply problem within the country. Since then these negative elements are firmly established in the economic activity.

5. Measures against income evasion in Hungary

The repressing of the black market - which is necessary everywhere - can only be conducted with versatile measures. Criminal activities such as drug traffic and smuggling have to be prevented by the criminal prosecution organ. Strict regulations in accordance with the EU legislation have to be established with the aim to close the gaps in the law. Here it is necessary though to treat the different reactions appropriate and considerate. It must not only be concentrated on penalties and sanctions. As a basic principle for the legislation it has to show to advantage that only those rules can be introduced that can be followed and (allowed to be) satisfied. It is practical to reduce over-taxation and national income centralization. Naturally not only fiscal but also regulating measures are needful. The black market has to be repressed by all means. It is not sufficient and little effective to reach the surface of the problem by means of sanctions. The fight against the black market can only be successful if reasons and causes are uncovered and eliminated. Hereby also long term methods have to be considered, such as moral education, law harmonization and effectiveness analysis of the various decisions. It has to be taken note of the fact that income evasion is a part of today's market economy. We have to cope with it while we naturally try to put the lid on the negative effects of income evasion. However even income evasion has positive aspects. A means of fight against it can be to seize the positive effects temporarily and not to eliminate them, which is not feasible anyway. Positive effects are that income evasion gives the poor, who are living under the breadline, an additional income. In this way they can secure their livelihood (moonlighting). The trade with goods of bad quality and no guarantee is reducing poverty, because these goods are available for everyone. Moonlighting enables the survival of unemployment and creates new "jobs", that otherwise would not be formed because of the high tax and contribution duties and would not be profitable. The black labour keeps those companies alive that would have to file bankruptcy due to tax burdens. The black market very often ensures higher salaries and higher independence than the legal economy. It can react very fast on shifts in demand and provide the desired goods and services. This is particularly important in times of crisis and recession. It is true as well that only a fraction of the

population can preserve these positive effects while the greater part of the population comes into a more and more difficult situation. The majority is not capable to complement their income in that way. It would be better of course if all that happened under legal circumstances. But as long as this all can be legalized these positive appearances should be also seen as a success in the fight against income evasion. We can and must proceed gradually and determined but considerate with the reduction of income evasion.

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